

Investment and Debt Securities Notes

Types of Investments

- **Debt Securities:** Financial instruments representing borrowed funds that must be repaid, typically with interest.
- **Equity Investments:** Ownership stakes in a company, with varying levels of influence based on ownership percentage.

Categories of Debt Investments

1. Held-to-Maturity:

- Debt securities the company intends and has the ability to hold until maturity.
- Accounting Method: Carried at amortized cost.

Levels of Equity Investment

1. No Influence (Less than 20% Ownership):

- The investor has minimal control over the investee's operations.

Six Methods of Accounting

1. Amortized Cost:

- Used for held-to-maturity debt securities, reflecting the initial investment adjusted for amortization of premiums or discounts.

Accounting for Investments in Debt Securities

1. Held-to-Maturity:

- Recorded and carried at amortized cost on the balance sheet.

2. Available-for-Sale Debt Securities:

- Accounted for at fair value, with unrealized gains or losses reported in other comprehensive income.

3. Trading Debt Securities:

- Accounted for at fair value, with unrealized gains or losses recognized in net income.

Reassessment of Classification

- At each reporting date, the investor company must evaluate the appropriateness of the classification of its debt securities investments to ensure alignment with the intended holding strategy.

Fair Value Option for Debt Securities

- An investor may elect to report a specific debt security at fair value, with changes in fair value recorded in net income, offering flexibility in financial reporting.

Accounting for Investments in Equity Securities

Without Significant Influence

- **No Significant Influence:** Occurs when ownership is less than 20%.

Two Situations:

1. Determinable Fair Value:

- Recorded at the cost of acquisition initially.
- **Realized Gain or Loss on Sale:**
 - Journal Entry:
 - Dr Cash (sales price)
 - Cr Gain (difference)
 - Cr Investment (original acquisition price)

2. No Determinable Fair Value:

- Carried at cost and assessed periodically for impairment to ensure the carrying amount does not exceed recoverable value.

Dividends Without Significant Influence

- **A. Cash Dividends:**

- Recorded on the date of record with the following entry:
- Dr Dividend Receivable (amount)
- Cr Dividend Income (amount)

- **B. Stock Dividends:**

- No journal entry is required as they do not represent a cash inflow.

- **C. Liquidating Dividends:**

- Paid from sources other than retained earnings, treated as a return of capital.

Equity Investment with Significant Influence (Usually 20–50% Ownership)

- **When to Use Equity Method:**

- Applied when the investor has significant influence over the investee's operating and financial policies.

Equity Method Events

1. Initial Recording:

- Recorded at cost with the following entry:
- Dr Investment in Company A (cost)
- Cr Cash (cost)

2. Investor's Share of Profit/Loss:

- The investment account is adjusted to reflect the investor's proportional share of the investee's profit or loss.

3. Cash Dividends Received:

- The carrying amount of the investment is reduced by the amount of dividends received.

4. Intercompany Events:

- The investor's pro rata share of profits or losses from transactions with the investee is eliminated for items not yet sold to outside parties at the financial statement date.

5. Goodwill Acquired in Equity Method:

- The excess of the purchase price over the fair value of net tangible assets is recognized as equity method goodwill.

6. Disposal of Equity Investment:

- A gain or loss is recognized based on the difference between the carrying amount and the selling price.

Financial Statement Presentation

- The investment account is presented as a single line item on the balance sheet, reflecting the net carrying amount.

Fair Value Option for Equity Investments

- The investor may opt to use the fair value option, with all gains and losses from changes in fair value reported directly in the income statement for enhanced transparency.